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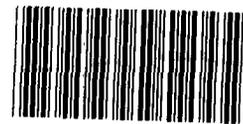
U.S. GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C.

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STATEMENT OF  
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FEDERAL PERSONNEL AND COMPENSATION DIVISION  
BEFORE  
SUBCOMMITTEE ON MANPOWER AND PERSONNEL  
SENATE COMMITTEE ON ARMED SERVICES  
ON  
MILITARY COMPENSATION ISSUES

Mr. Chairman and Members of the Subcommittee:

As always, I welcome the opportunity to appear before you to discuss those military compensation issues which are of concern to this committee. In previous appearances before you I have discussed the multifaceted nature of the services' manpower problems. As you know, we believe that the underlying questions that should be addressed in all compensation-related issues are: What are the most reasonable, cost-effective incentives or mix of incentives for achieving the military manpower objectives? And, do the incentives authorized provide military manpower managers with the necessary tools and flexibility to achieve the manpower objectives at the lowest possible cost?



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Today, within the general framework of these guidelines, I will discuss some of the implications of the Administration's proposed freeze on basic pay and allowances; how this proposal may affect the concept of pay "comparability" versus "competitiveness" with the private sector; and questions raised about how military pay is annually adjusted. Also within this general framework, I will discuss our views on the congressional proposals for a new post-service educational assistance benefit program, and the Administration's proposal to make permanent the 50 percent limitation on retired pay cost of living adjustments (COLA) for military retirees under age 62.

IMPLICATIONS OF THE PROPOSED  
FREEZE IN BASIC PAY AND ALLOWANCES

The President has announced that for fiscal year 1984 he intends to ask military members to forego the scheduled across-the-board pay increase in basic pay, subsistence, and housing allowances; that is, a freeze of those three compensation elements which, along with the Federal income tax advantage on the non-taxable allowances, are known as Basic Military Compensation (BMC). DOD's initial planning assumption was that an across-the-board 7.6 percent increase in basic pay and allowances would be needed to maintain pay "comparability" with the private sector. The Pentagon estimates that foregoing this across-the-board pay raise will save about \$2.9 billion in fiscal year 1984.

Although not directly offered in support of the pay freeze proposal, in recent weeks, the Secretary of Defense and other Defense officials have begun to use the phrase "competitive" rather than the more traditional "comparable" when discussing long-term goals for military compensation. Is the proposed pay freeze for fiscal year 1984 competitive rather than comparable? If so, what are the differences, and is the adoption of "competitiveness" as a compensation principle justified? These are the questions we will be addressing in this section of our presentation.

In conceptual terms, we see a distinct difference between competitive and comparable military compensation systems. For purposes of discussion, we offer these definitions.

--"Comparable" compensation would equate all elements of compensation--not just Basic Military Compensation--received by military members to all the elements received by workers in comparable skills and experience levels in the civilian economy.

--"Competitive" compensation would carry comparability one step further by adding a possible adjustment in military compensation to account for market conditions of supply and demand and the advantages and/or disadvantages of military service.

Although the Department of Defense and the Services have equated their pay policies of recent years to a quest for comparability, their decisions have fallen short of true

comparability in two areas: (1) their basis for comparison with civilian earnings has generally been limited to Basic Military Compensation without a strict similar limitation on comparable civilian earnings, and (2) standards of comparability between the military and the private sector for equivalent levels of work, experience, or responsibility have never been established; instead broad general comparisons have been used.

The Rivers' Amendment, enacted in 1967, provided a tie between military basic pay and allowances and Federal white-collar pay--and thus an indirect tie to private sector pay changes via the Professional, Administrative, Technical, and Clerical (PATC) survey. However, it did not provide a direct tie to private sector pay, and, more importantly, it did not establish standards of comparability between the military and the private sector. The linkage, established in 1967, was to be temporary until military pay standards could be developed and, in essence, it merely assured that whenever Federal white-collar pay would go up, military basic pay and allowances would go up by a like percentage. The temporary linkage, however, did not take into account the many other components of military pay.

What often confuses this issue even further is the notion that the extraordinary increases in basic pay and allowances of 1971 and 1972, made in preparation for the All-Volunteer Force,

somehow made military pay comparable to private sector pay. This simply is not the case. These raises made military pay more competitive, but standards of comparability for equivalent levels of work, experience, and responsibility were not established at that time, and have not been established to this day.

Interestingly, the Gates Commission report, which formed the basis for justifying the large 1971 and 1972 pay raises, showed that total military compensation for enlisted members with 5 or more years of service and for officers with 4 or more years of service, already exceeded total private sector civilian compensation by substantial percentages.

In stating that military pay should be "competitive" with private sector pay, Defense officials have included the total military pay package; that is, BMC plus the long list of other special and incentive pays and allowances service members receive. While, in theory, the pay package in its entirety should have been included in any past discussions of "comparability," usually it was not.

To illustrate the value of the pay elements that should be added to BMC in order to calculate a true comparability basis, I will use the preliminary results of a study we are doing at the request of Senator Exon. One objective of this study is to determine what proportion of the force receives some type of pay

in addition to BMC, and how much this additional pay is worth. The services know and can provide data, for example, on how many people receive variable housing allowance, how many receive sea pay, how many receive bonuses, etc. However, what they have not quantified up to now is how many members may be receiving several of these pays, and how much the additional pays are worth in relation to BMC. What we found provides some very useful insights when considering the issue of what pay elements should be included in "comparable" or "competitive" pay. For example, our study shows that:

--62 percent of Navy and 56 percent of Air Force personnel receive some additional pay, and most of those who do not receive additional pays live in Government-furnished housing for which no rent is paid.

--68 percent of Navy additional pays exceed \$1,200 per year.

--88 percent of Navy and 82 percent of Air Force O-3 to O-6, receive some additional pays with 56 percent and 40 percent, respectively, receiving at least an additional \$3,600 per year.

--81 percent of Navy E-5s through E-9s receive additional pay, 35 percent of whom receive at least \$2,400 or more per year.

I have included as an appendix to this statement several illustrative examples of what these additional pays are worth for

Navy and Air Force members at various grade levels. Army was not included in this analysis because their data was incomplete.

In our opinion, the concept of "competitive" pay, as currently being discussed by Defense officials, helps one to focus more clearly on total military pay, and on whether the mix of pays, allowances, and other incentives being offered are efficiently and cost-effectively addressing specific manpower problems. As I have testified before, we believe that the entire pay package should be considered in its totality, not on a piecemeal basis, and that one should strive to include in the pay system as many of the "ideal" ingredients of a good management system as possible. We believe that the shift in emphasis to "competitive" military pay is a step in this direction.

What, then, does this discussion of pay "comparability" versus "competitiveness" mean in the context of the President's proposed freeze on BMC? The evidence suggests that foregoing an across-the-board increase in basic pay and allowances will not have a serious adverse impact on the services' ability to attract and retain the quality and quantity of people they need to meet the manning requirements for the various occupational specialties. At the present time some military occupations are being overpaid as compared to what relevant labor market conditions would indicate, and, without supplemental pays and

bonuses, others would be underpaid. A study we currently have underway demonstrates this point. We found that mid-level career Navy personnel who left those generally easy-to-fill Navy occupations during the first quarter of fiscal year 1982, took an average pay cut of \$5,900 per year in their first civilian job out of the Navy. However, those leaving highly technical jobs took only a relatively small pay cut when they left the Navy. In contrast, our study found that in 1980 military pay was not competitive for either group. This suggests that in some areas the large increases and other changes in military compensation--such as the addition of the variable housing allowance--have raised service compensation from below comparable civilian pay to substantially above for some occupations.

In general, the across-the-board philosophy for setting and adjusting pay has resulted in a BMC pay line that is higher than necessary in some areas. In our opinion, foregoing an across-the-board increase in BMC this year would help bring military pay more in line with market place conditions, provided of course that the necessary occupational differences are accommodated by targeted special pays. As you may recall, because of the tight budgetary situation last year, we suggested that a portion of the resources being considered for a general pay raise be targeted to those areas where manpower shortages exist. We suggested that this could be done through existing manpower management programs, such as the selective bonus programs or through a greater use of

proficiency-type pays. We believe that the President's proposal not to increase the BMC components of pay this year is consistent with our view that available resources should be targeted to where they are most needed. Although we have had concerns and disagreements with the services from time to time about how they manage and use these special and incentive pays, including the bonus programs, we fully support them in concept and urge that they be adequately funded.

PAY ADJUSTMENT MECHANISM ALSO MERITS DISCUSSION

An appropriate mechanism for periodically adjusting military pay levels should be part of any discussion concerning military compensation, and "competitive" or "comparable" goals. As I have explained, the current mechanism--that is, the indirectly link of BMC to private sector pay changes--was intended to be temporary until military pay standards could be developed and agreed upon. Unfortunately, standards have not been developed, and the temporary indirect linkage to the PAIC index via Federal white-collar workers remains. However, over the past couple of years, the military has been urging that a direct linkage be established between the cash elements of BMC and the Employment Cost Index (ECI). The military would prefer the ECI as the direct linkage adjustment mechanism over PATC or other indices on the grounds that it is more reflective of a broader range of military occupations.

We support the military proposal that its pay adjustments be permanently de-linked from civil service pay adjustments, and we agree the ECI is preferable to PATC or other available indices. However, we do not support the proposal that only one element of military pay, namely BMC, be tied directly to any index, including the ECI. Instead of directly indexing one military pay component, we believe that it would be more desirable to use the ECI as a guide for determining the size of the total "competitive" compensation pie, while at the same time giving the Secretary of Defense the authority to allocate the money to those areas where it is most needed to enable the services to compete with private industry for their manpower needs. (This is similar to a recommendation contained in the 1978 report of the President's Commission on Military Compensation.) If, however, the ECI is to be used as the firm basis for adjusting "comparable" military pay, the entire military pay package should be brought into the equation rather than using a multi-dimensional index to adjust only one dimension of military pay.

IS A GI BILL NEEDED TO ADDRESS RECRUITING PROBLEM?

Proposals to reinstate a GI Bill--but based on recruiting and retention needs rather than rewards for difficult service--also will be considered by this Committee in the foreseeable future. In this light, then, are there manpower problems facing the services that could be cost-effectively addressed and corrected by new post-service educational benefits?

Since the inception of the AVF, the Active Force has never been more than about 1.5 percent below their total funded authorized strength and only rarely have the services failed to meet their quantitative recruiting goals. There have been serious reserve shortfalls, but in the Active Force there has been no across-the-board problem recruiting the right aggregate number of people--a problem that might call for an across-the-board solution. Instead, we find that recruiting a sufficient number of high-quality men to serve in the enlisted ranks and willing to serve in combat occupations or with the aptitude needed for certain highly technical jobs has been a serious problem, primarily for the Army.

As a result of these problems, experiments have been conducted with more generous versions of the Veterans Educational Assistance Program (VEAP), numerous proposals for a GI Bill were introduced and debated at length in the 96th and 97th Congresses, and proposals have been introduced in this Congress, including S. 8, S. 691, and S. 667.

Given the nature of the services' manpower problems, can an educational assistance benefit program be justified on grounds of cost efficiency and effectiveness? A comparison of several key components of the proposed programs with an "ideal" management system provides useful insights.

Under most educational assistance proposals, including S. 8, S. 691, and the proposed VEAP enhancement (S. 667), Defense

managers would not have the authority to apply or remove the incentive on a timely basis as the high-quality recruit problem increases or decreases, as it has over the past 6 years. Also, Defense managers generally would not have the authority to target the basic incentive to the specific problem area--a particular service or particular skills--thus reducing its cost-effectiveness. Managers would not have the flexibility to adjust the basic incentive as conditions change, and problems in Defense's information feedback system would prevent managers from knowing just how well the incentive might be working. Further, while S. 8 contains a provision for evaluating its continued need on a periodic basis, a GI Bill could soon become institutionalized and looked upon as a "right" rather than as an optional incentive.

Because the "incentive" would be paid to many people who would not need it to join or stay in the service, much of the expenditure would be unnecessary. For example, if a GI Bill were to be enacted which was limited to high school diploma graduates, the supply of such people could be expected to increase by 5 to 10 percent. In other words, to attract every 21st or possibly 22nd quality recruit, the incentive would be paid to 20 others who could be expected to enlist without it. As a consequence of this, the cost per additional quality enlistee would be very high.

One important feature of S. 8, which has not been part of most other GI Bill proposals, including S. 691, is that it requires the President, upon the recommendation of the Secretary of Defense, to activate the bill after taking into account (1) the projected cost of the improved benefit program (2) the services recruitment and retention experience and projected experience, and (3) the cost of other alternatives for improving recruiting and retention. Thus, because of the services recent recruiting and retention successes, at least in the near term, even if S. 8 were enacted, it is not likely that it would be activated. However, this feature, as we read it, does not require a clear finding and determination that the improved educational benefit be used only if it is the most cost-effective alternative incentive for achieving the recruiting and retention goals.

S. 8 also contains a provision for deactivating the program after taking into account the same conditions considered when the program was activated. Again, this is a very positive feature of this bill; however, as you know, programs of this nature are often difficult to stop once begun, regardless of whether they can continue to be justified on a cost-effectiveness basis.

In contrast to most previous GI Bill proposals, S. 8 and S. 691 also contain provisions for career personnel to retain their educational assistance rights until they are discharged, thus

countering pressures to leave the service in order to "use or lose" their rights. The Supplemental Educational Assistance feature of S. 8 also would encourage first-termers to extend or to reenlist in order to gain the additional benefits. This could be a desired phenomenon in most cases, but may not be the most cost-effective method of gaining such additional service.

Another positive feature of S. 8 which has generally not been found in other GI Bill proposals is that the educational benefits would be paid for by the Department of Defense rather than by the Veterans Administration. This should encourage Defense managers to consider the cost of educational assistance along with that of other available incentive options and through this tradeoff analysis process help the services choose the most cost-effective incentive. An additional feature not in this proposal which would further encourage Defense managers to make realistic tradeoff analyses would be to adopt an accrual accounting approach so that future liabilities would be more clearly reflected in the current budget. S. 691 would also require Defense rather than Veterans Administration funding, but under this proposal, Defense managers would not have the option of using the most cost-effective incentive since this bill, if enacted, would become effective on a specific date contained in the bill.

Consideration of S. 667--a bill which would require the Government to contribute \$3 rather than \$2 to the basic VEAP for each \$1 contributed by the service member--also should be guided

by an evaluation of its impact on the recruiting marketplace, its need, and whether alternative programs would meet the manpower demands of the services in a more efficient and cost-effective manner.

Concerning the need for a VEAP enhancement, all the services have reported that the basic VEAP program has had only minimal effect on recruiting. This is consistent with the findings of a March 1982 Congressional Budget Office study which reported the basic VEAP (without kickers) offers very little recruiting improvement. In contrast, however, the Army has reported great satisfaction with Ultra-VEAP, a program which allows up to \$12,000 in bonuses to be added to the \$5,400 contributed by the Government under the basic VEAP program. Of the four services, only the Army uses the Ultra-VEAP authority.

Because of the requirement for a service members' contributions under VEAP and the negative impact of this on participation rates, the overall cost of VEAP--even with the proposed enhancement--would likely be less than the cost of other proposed GI Bills. Despite such lower cost, however, the question that should be addressed concerns the need for the VEAP program. As recent history shows, only the Army of the four services has had major problems in attracting high-quality recruits, and they have been able to counter these with the use of Ultra-VEAP and other incentives. Accordingly, we see little

need at this time to enhance the basic VEAP benefit. We also see little justification at this time for enactment of GI Bill authorization legislation.

SHOULD THE LIMITATION ON RETIRED  
PAY COLA BE MADE PERMANENT

This committee also is likely to consider the President's 1984 budget proposal to make permanent the limitation on cost-of-living adjustments (COLA's) for nondisability military retirees by allowing one-half of the full COLA increase for retirees under age 62. At the present time there is a temporary 50 percent COLA limitation for retirees under age 62 which applies to the fiscal years 1983 through 1985 adjustments.

The military retirement system has been a prime target for budget-cutting because of (1) its enormous cost--\$17 billion for fiscal year 1984, projected to grow to \$34 billion by 1994--and (2) the perception that the system provides more generous benefits than necessary--members may retire at any age upon completing 20 years of service and, up to 1983, retired pay was fully indexed to changes in the Consumer Price Index (CPI).

Over the past decade, at least five major commissions or study groups have recommended changes to the military retirement system, the most recent being the President's Commission on Military Compensation in 1978. However, the services have generally supported the current system, which is essentially

geared to a 20-year career, because (1) they believe it insures a stable supply of experienced personnel and (2) it supports the up-or-out promotion system. They have generally been able to fend off reform proposals on the basis that the studies and reviews have not adequately addressed what they consider to be the underlying reason for the current retirement system structure--that is, that the system must remain responsive to the management of the active force in support of defense requirements. In short, the services' view is that the current retirement system provides their desired force profile, and they argue correctly that any changes in the retirement component of the compensation system will have some affect on their age/experience profile. However, in our opinion, the question the services have not satisfactorily addressed to date is whether the force profile produced by the current compensation system is the most effective or whether different profiles, supported by a different retirement system, would be more effective and less costly. The lack of agreement regarding the force profile has been the underlying reason why fundamental reforms of the military retirement system have not been made despite the many commission and study group recommendations.

We believe that the current military retirement system does not necessarily produce the most effective force profile at the least cost. The current system causes active duty members to

make career decisions which are not always in the services' best interest, both in terms of causing too many people to stay at some career points, and not enough at others. However, we have also recognized that major changes to the retirement system which substantially reduce life-stream earnings of active duty personnel should not be made without a full understanding of how such a change will affect the force profile.

There is little question that the proposal to limit permanently the COLA increase for retirees under age 62 to one-half of the CPI would reduce the life-stream earnings of active duty personnel. For example, the purchasing power of a typical E-7 retiring at age 41 would be reduced by 46 percent by age 62 and that of the typical O-5 retiring after 20 years of service would be reduced by about 40 percent. What is not known, however, is how this change in the retirement system would affect active duty members' career decisions and whether the cumulative affect of member's career decisions would produce a more or less effective force at a higher or lower cost. GAO has suggested in the past that annual COLA increases for both Federal civilian and military retirees could be limited to something less than the full CPI increase. However, we also recognized that such decision should not be made without first knowing the full consequences of the action.

The Fifth Quadrennial Review of Military Compensation (QRMC), currently underway, is conducting an overall review of military retirement. We have been informed that an initial step in this process is to obtain from the individual services their views as to what the objective force profile should look like; that is, in an environment unconstrained by the current systems, what would be the composition of an "ideal" baseline force. This involves questions about the most desirable number of career personnel in all year-of-service groups, including the ideal number that should be retained beyond 20 years of service. We are encouraged by the QRMC's efforts, but we should call to your attention that other groups' attempts to reform the military retirement system have faltered--in the final analysis--on the unwillingness of the services to fully accept the resulting force profile changes. Consequently, we are hopeful--but not confident--that the QRMC will produce the desired changes. If they do, it is likely that the changes will be more defensible from a force manning perspective than the proposed COLA cap; if they fail, enough time will remain before the current cap expires for alternative actions. Accordingly, we believe that the Committee should defer any decisions on the legislative proposal to make the 50 percent COLA cap permanent until the report of the QRMC is available and there is time to complete any follow-up analysis.

## SUMMARY

Mr. Chairman, we have covered a number of interrelated compensation issues this afternoon, all of which I discussed in the context of a compensation system structure which allows and encourages military managers to use the most cost-effective mix of incentives available for achieving their manpower objectives. Implicit in the concept of using cost-effective incentives is the need for Defense managers to (1) identify the specific manpower problems that need to be solved, (2) perform tradeoff analyses among the alternative solutions, and (3) have the authority to select the most efficient and cost-effective mix of monetary and non-monetary incentives.

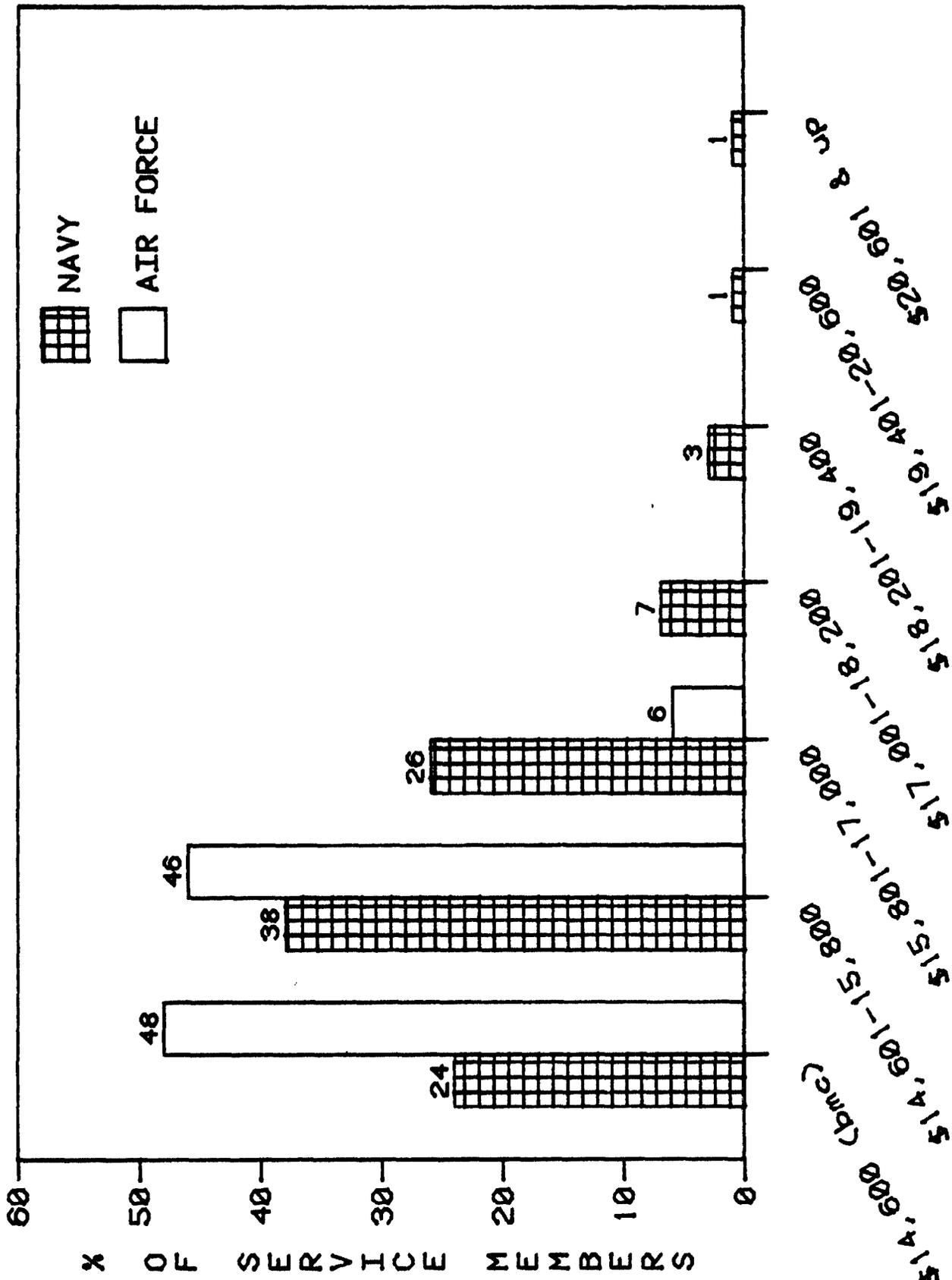
In summary, then, we believe that:

--The President's proposal to freeze the BMC components of military pay is consistent with our position that the current base pay line is already generally competitive with private sector pay and that, where pay is not competitive, available resources should be targeted to specific manpower problem areas. This means that the selective bonus and other incentive programs must be judiciously managed and adequately funded, perhaps even at higher than requested levels.

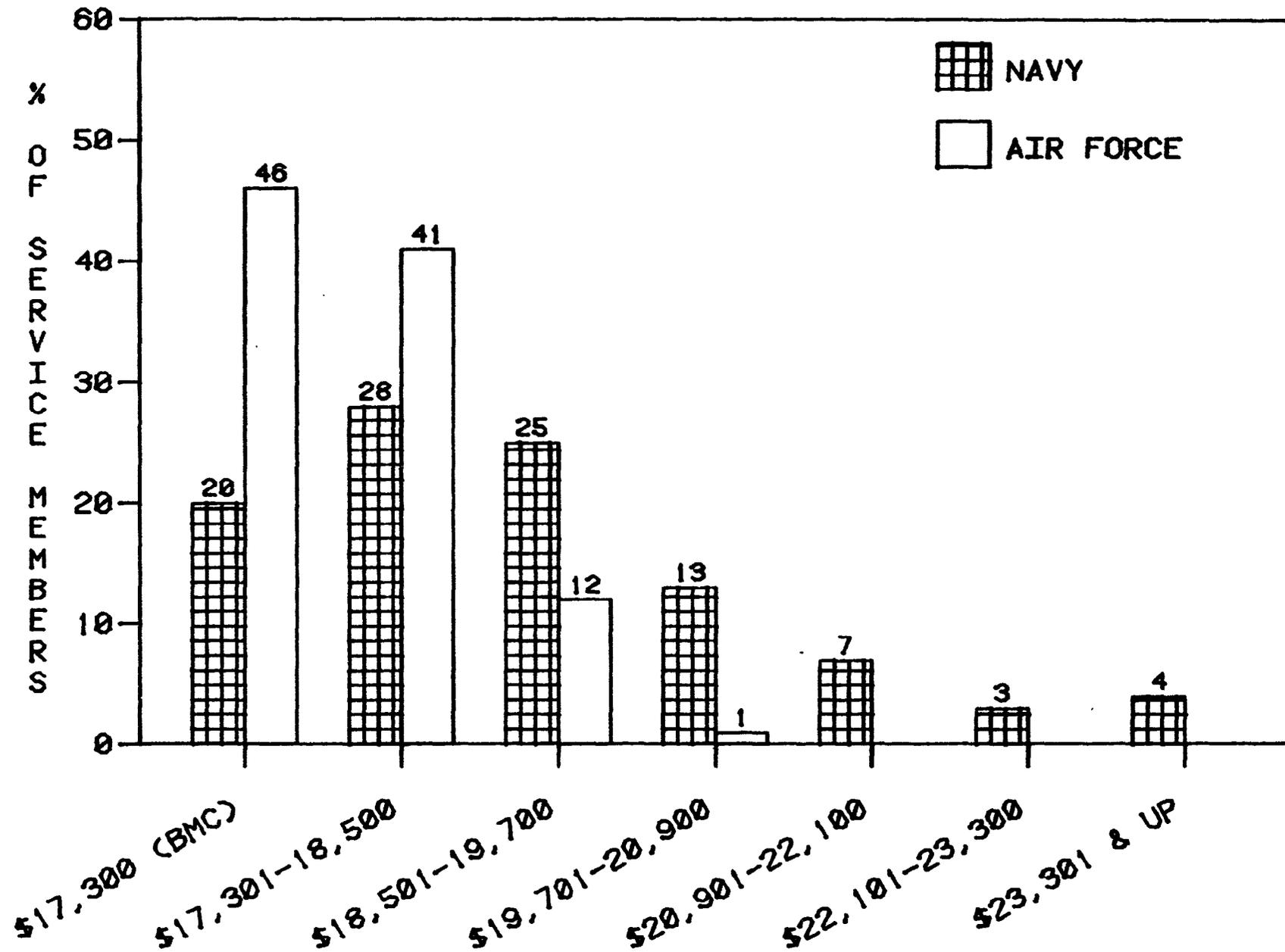
- The proposal to permanently de-link military pay adjustments from civil service pay adjustments should be adopted, but the proposal to link only one element of military pay, namely BMC, to pay changes in the private sector should be rejected. Instead, the ECI should be used as a guide for determining the size of the total compensation package, with the Secretary of Defense given more authority to target the money in order to enable the services to compete with industry on an occupational basis for their manpower needs.
- Given the nature of the services' manpower problems, the inflexibility of most GI Bill proposals, and the relatively high cost of such programs as compared to other available recruitment and retention incentives, we see little justification at this time for either a new educational assistance benefit program, or an increase in the Government's contribution to basic VEAP.
- In light of (1) the current work of the Fifth QRMC in reviewing the total military retirement system, and (2) the fact that a temporary 50 percent limitation on COLA for retirees under age 62 will be in place through the 1985 adjustment, action to make this limitation permanent should be deferred until the report of the QRMC is available and its recommendations evaluated.

Mr. Chairman, this concludes my formal statement. We would be happy to respond to any questions you may have.

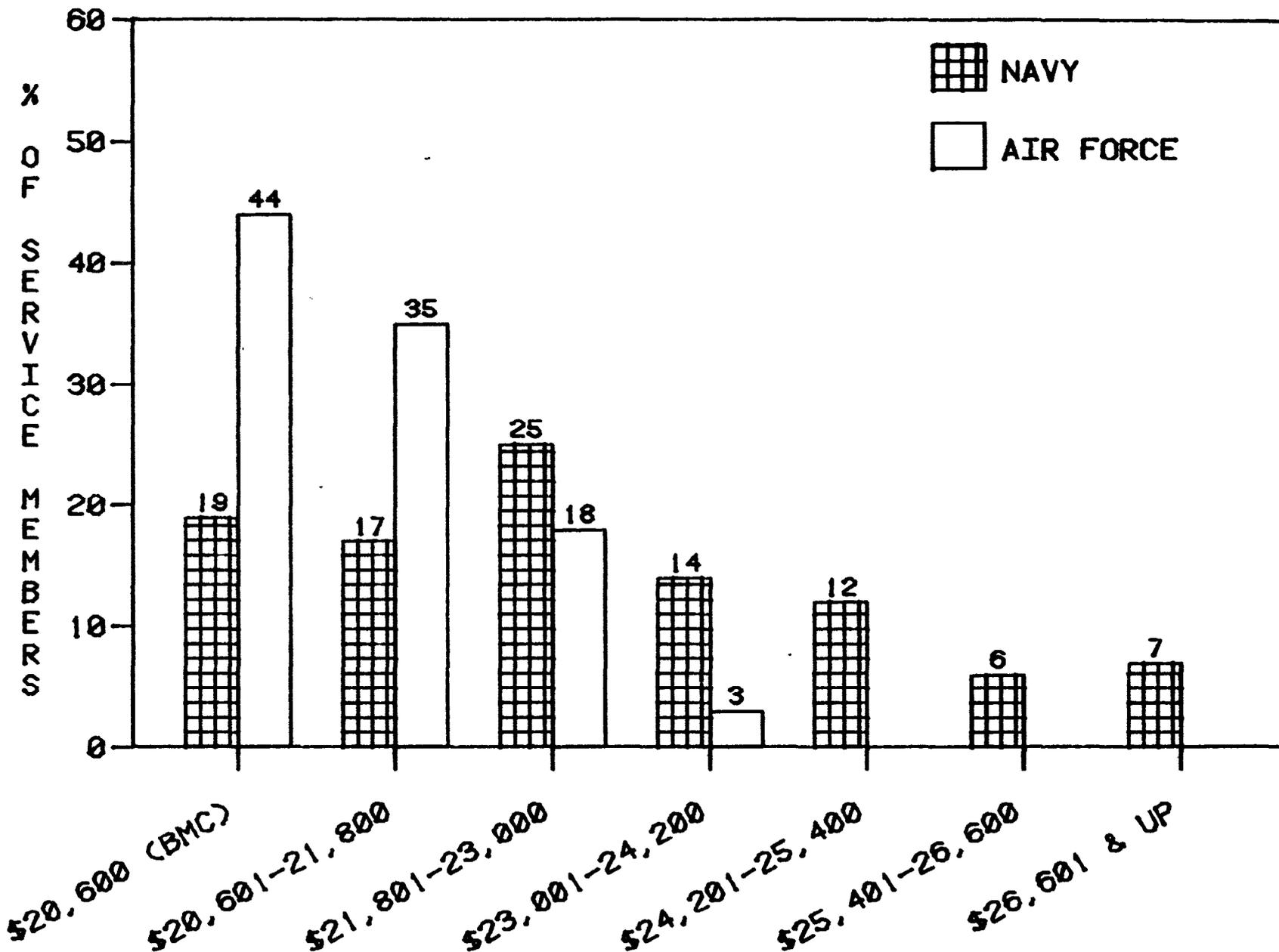
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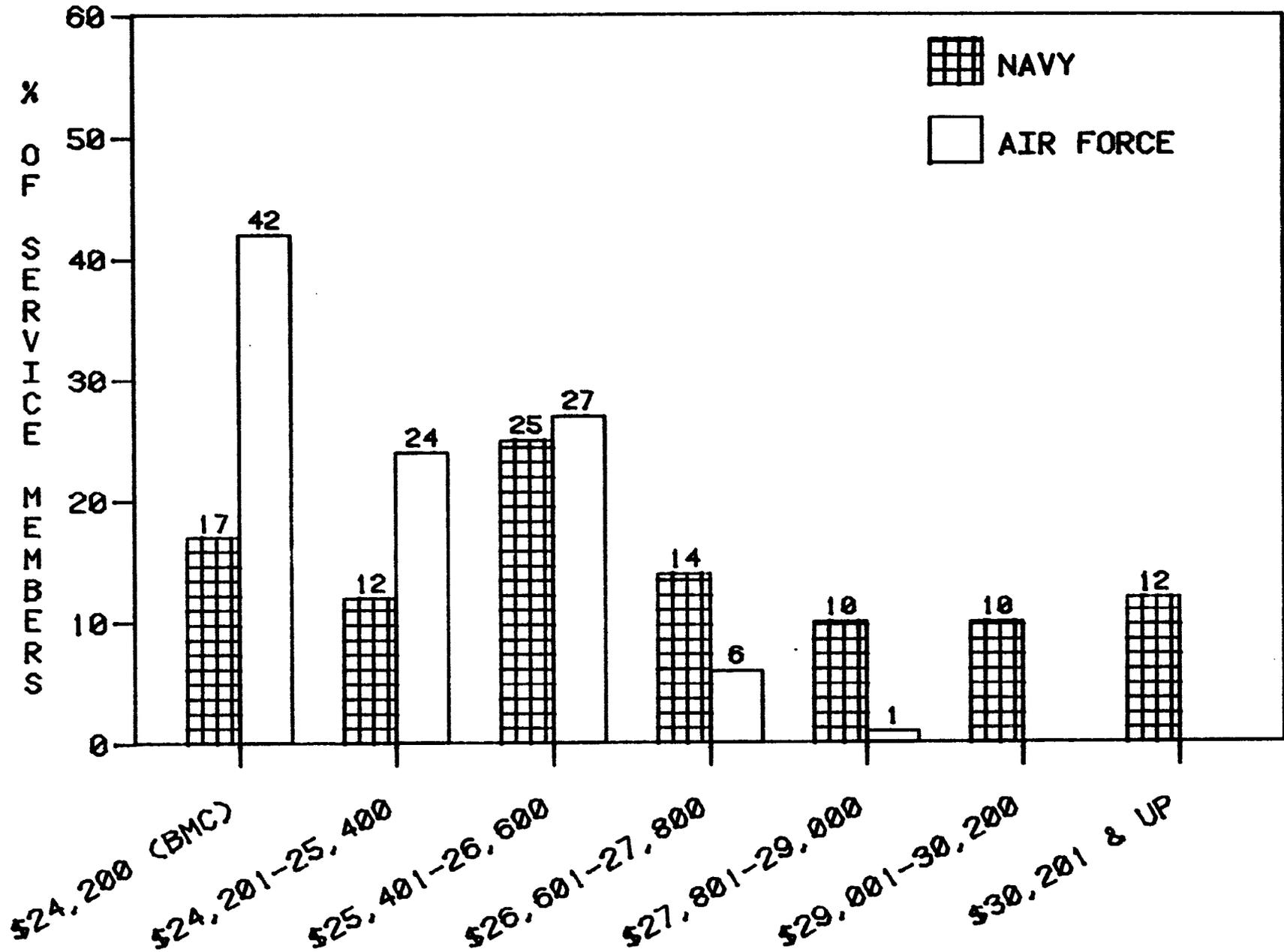
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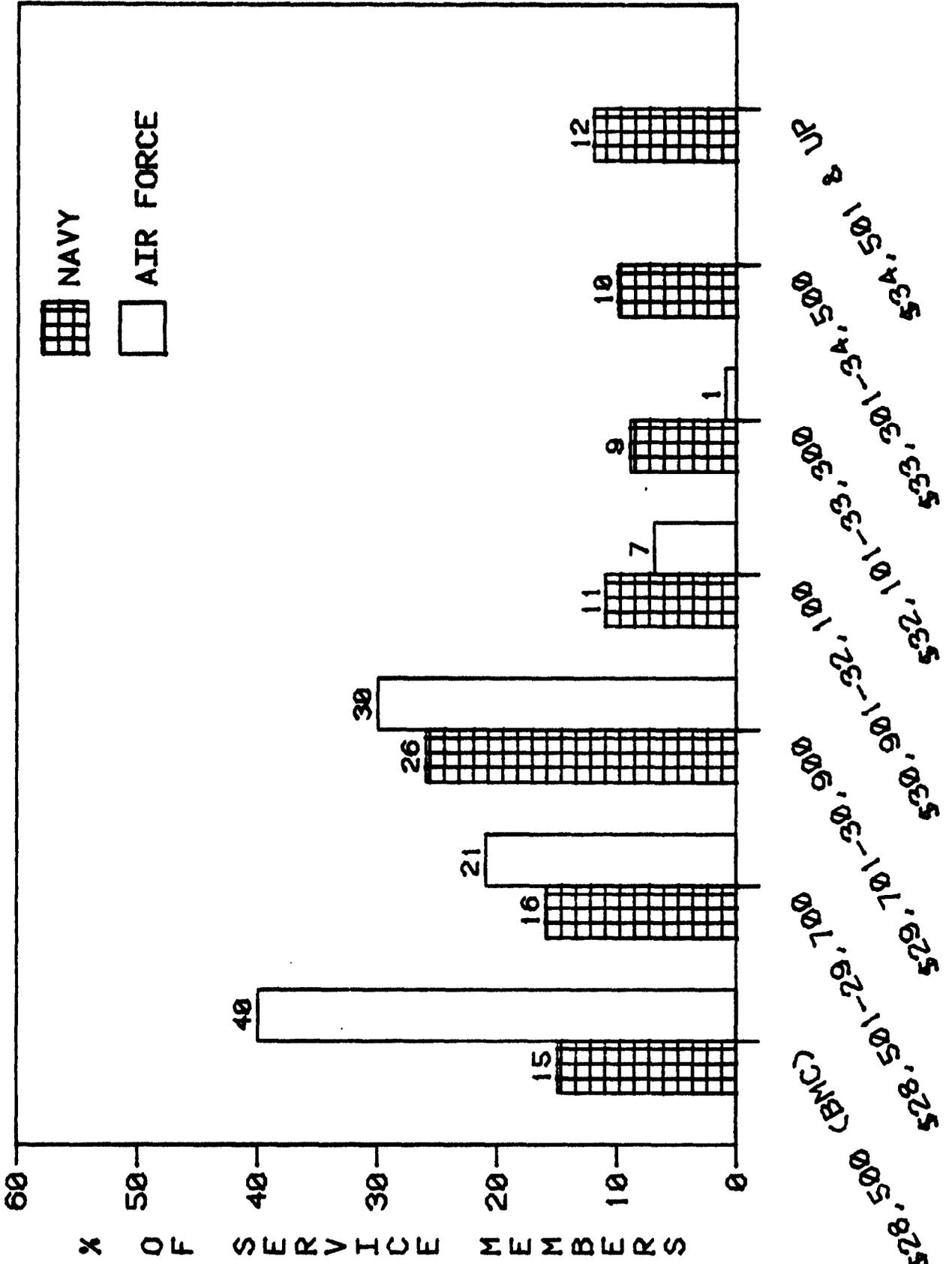
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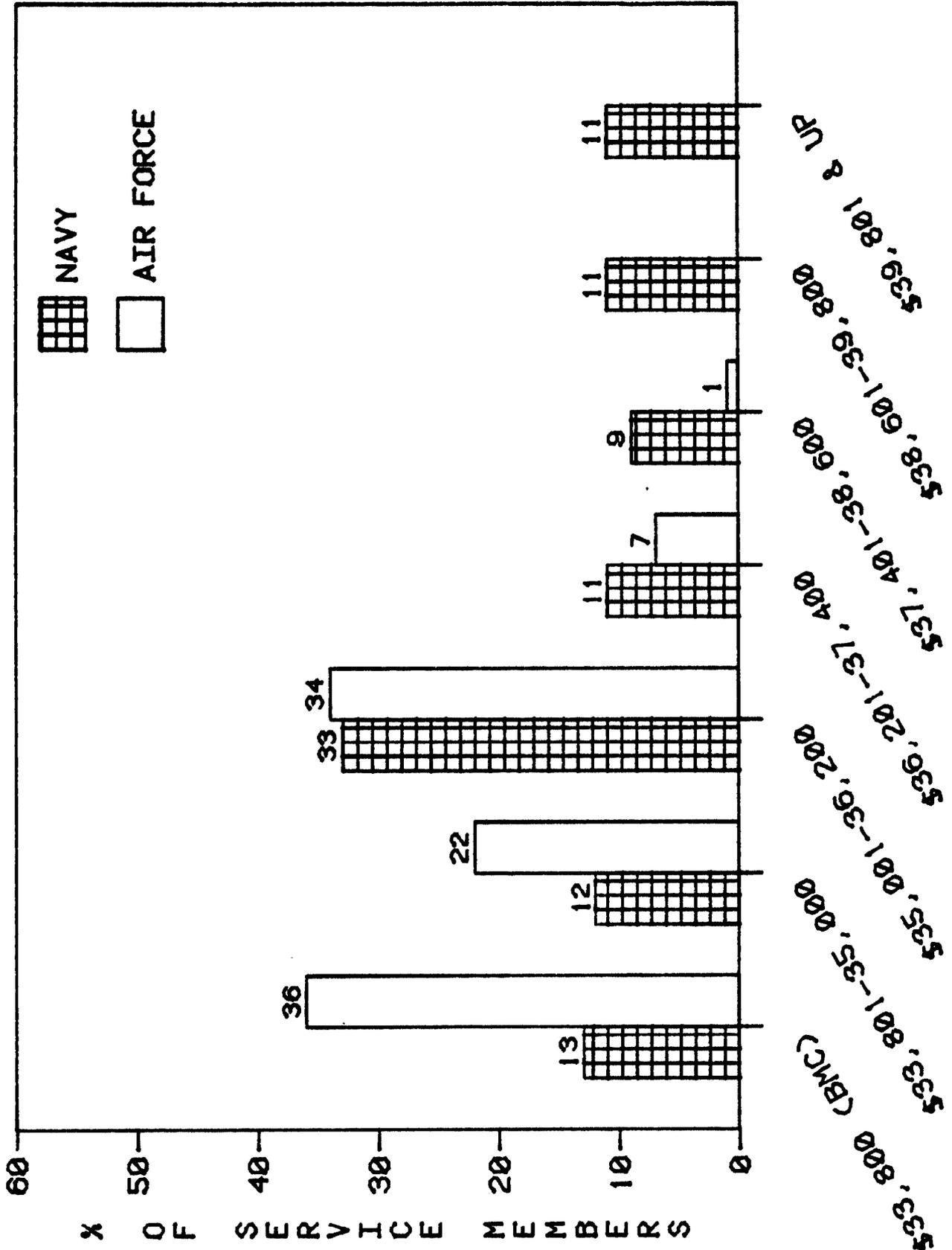
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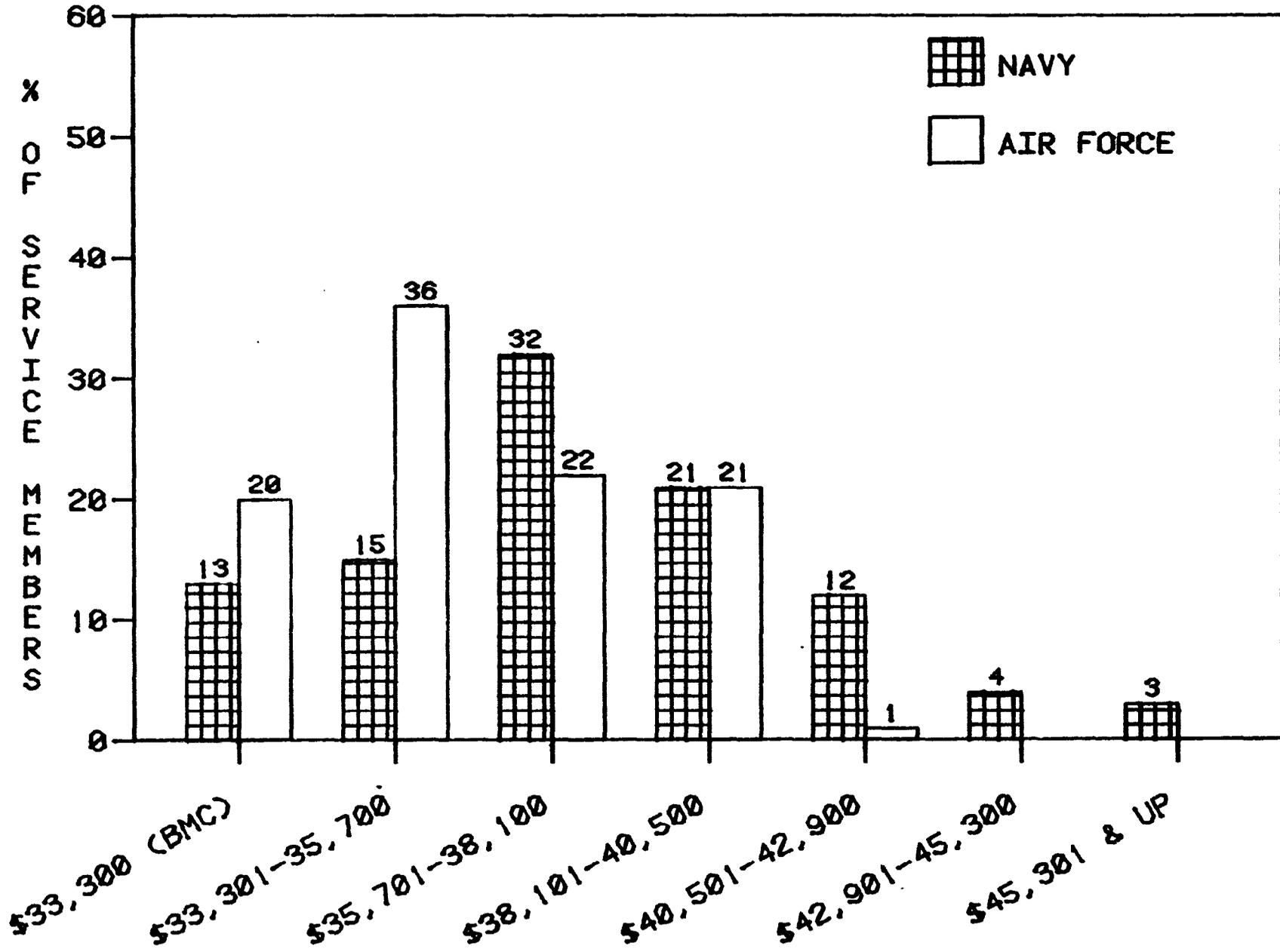
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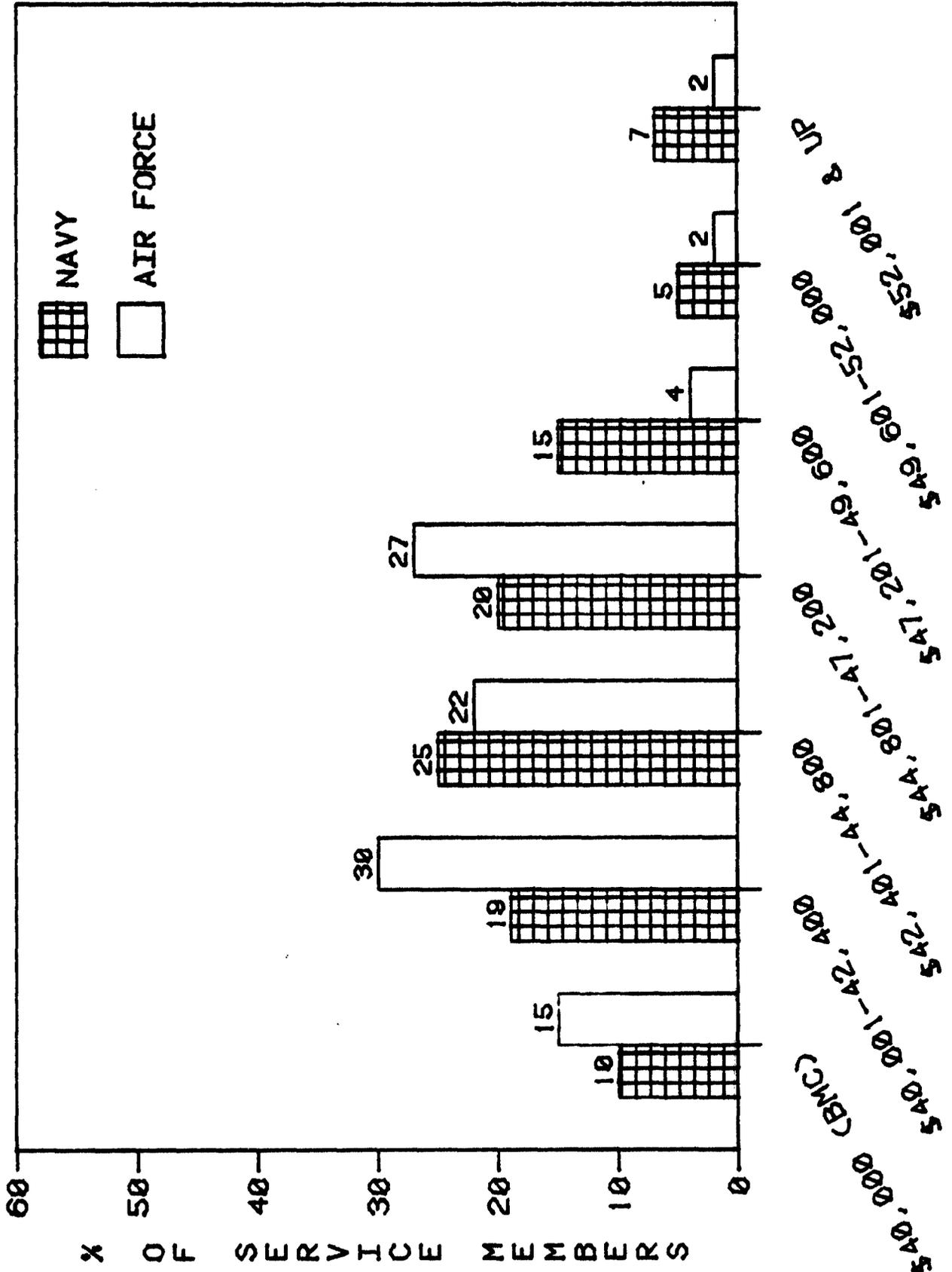
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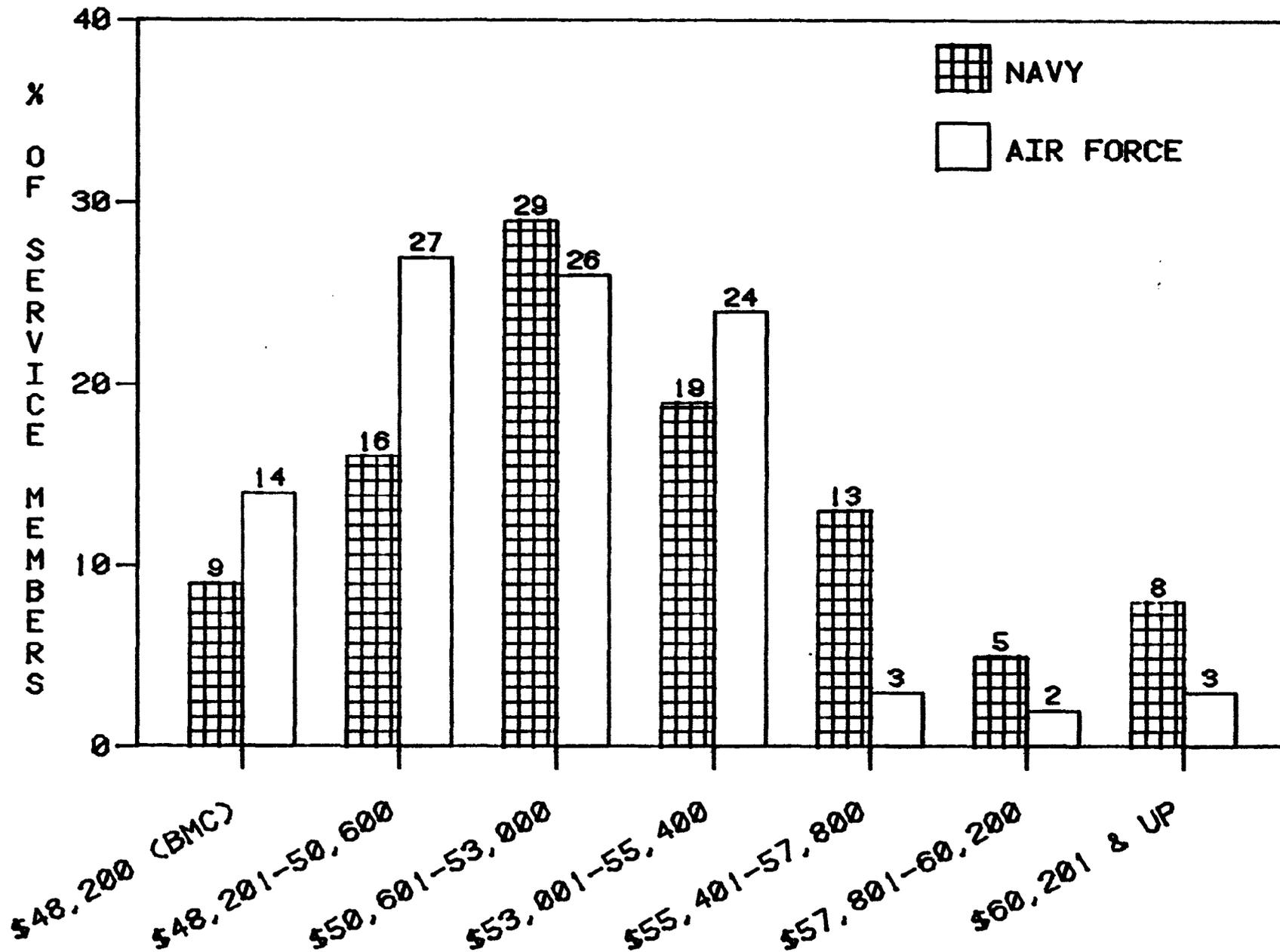
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IN ADDITION TO BASIC MILITARY COMPENSATION (BMC)**



NAVY AND AIR FORCE-GRADE O-4  
 PERCENT RECEIVING SELECTED PAY ITEMS---INCLUDING VHA---  
 IN ADDITION TO BASIC MILITARY COMPENSATION (BMC)



**NAVY AND AIR FORCE--GRADE 0-5  
 PERCENT RECEIVING SELECTED PAY ITEMS--INCLUDING VHA--  
 IN ADDITION TO BASIC MILITARY COMPENSATION (BMC)**



**NAVY AND AIR FORCE--GRADE O-6  
PERCENT RECEIVING SELECTED PAY ITEMS--INCLUDING VHA--  
IN ADDITION TO BASIC MILITARY COMPENSATION (BMC)**

